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IN THE

Supreme Court of the United States

October Term, 1958
No.

ELIAS MILLER, PAUL MILLER, ANNA MILLER and HELEN MILLER, and ELIAS MILLER and PAUL MILLER, as Executors of the Estate of GEORGE MILLER, Deceased,
Petitioners,

vs.

IRVING SULMEYER, Trustee in Bankruptcy of the Estate of DELCON CORPORATION, Bankrupt,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

BRIEF OF RESPONDENT IN OPPOSITION.

Opinions Below.

The opinion of the Referee in Bankruptcy is unreported, but appears at pages 32-53 of the Record.[1] The District Court for the Southern District of California rendered no formal opinion; its findings of fact, conclusions of law and order are unreported, but appears at pages 63-70 of the Record. The opinion of the Court of Appeals for the Ninth Circuit is reported at 263 F. 2d 513.

Jurisdiction.

The judgment of the Court of Appeals was entered on January 16, 1959. A petition for rehearing was denied

[1]All citations to the "Record" refer to the Transcript of Record in the Court of Appeals.

on April 17, 1959. The petition for certiorari was filed on June 8, 1959. The jurisdiction of this Court is invoked under 28 U. S. C., Sec. 1254(1) and Section 24c of the Bankruptcy Act, 11 U. S. C., Sec. 47c.

Statutes Involved.

Bankruptcy Act, Section 70e(1), 11 U. S. C., Sec. 110e(1):

> "A transfer made or suffered or obligation incurred by a debtor adjudged a bankrupt under this Act which, under any Federal or State law applicable thereto, is fraudulent as against or voidable for any other reason by any creditor of the debtor, having a claim provable under this Act, shall be null and void as against the trustee of such debtor."

Bankruptcy Act, Section 70c, 11 U. S. C., Sec. 110c:—

> "The trustee, as to all property, whether or not coming into possession or control of the court, upon which a creditor of the bankrupt could have obtained a lien by legal or equitable proceedings at the date of bankruptcy, shall be deemed vested as of such date with all the rights, remedies, and powers of a creditor then holding a lien thereon by such proceedings, whether or not such a creditor actually exists."

California Civil Code, Section 2957:

> "A mortgage of personal property . . . . is void as against creditors of the mortgagor and subsequent purchasers and encumbrancers of the property in good faith and for value, unless

. . . . . .

"4. The mortgage, if of personal property other than crops growing or to be grown or animate personal property, is recorded in the office of the recorder of the county where the property mortgaged is located at the time the mortgage is executed. . . ."

Question Presented.

Whether the Court below was correct in holding that the trustee in bankruptcy could avoid in its entirety a chattel mortgage, which, on the date of bankruptcy, was invalid under California law as against certain creditors of the bankrupt.

Statement.

In June, 1954, petitioners sold a machine shop business to the bankrupt, accepting a portion of the price in cash with the balance secured by purchase money chattel mortgage. The security instrument, however, was not promptly recorded as required by California statute, there being a delay of 79 days in filing. The effect of this oversight was to render the mortgage invalid under the state law as against creditors of the bankrupt whose claims arose prior to the tardy recordation.[2] As of the time of bankruptcy, there were still in existence creditors possessing claims of $8,906.95 who could so attack petitioners' security.

In December, 1954, petitioners repossessed the chattel mortgaged assets because of the bankrupt's default in making payments.[3] Bankruptcy occurred on February 23,

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[2]*E.g., Ruggles v. Cannedy*, 127 Cal. 290, 298-302 (1899).

[3]At the time of repossession of the assets in December, 1954, the bankrupt was insolvent and petitioners knew it. [R. p. 66.] Petitioners assert at several places in their brief here that the bankrupt was solvent on the dates the mortgage was executed and recorded.

1955. Thereafter, in March, 1955, petitioners sold the assets for $82,500.00, their then fair value.

Petitioners filed a creditor's claim in the bankruptcy proceeding for the balance owing to them, after allowance to the bankrupt of a credit for the amount received on the foreclosure sale. Relying primarily on Sections 70e and 70c of the Bankruptcy Act, the trustee counterclaimed for $82,500.00, the proceeds of the mortgaged assets which petitioners had sold.

The Referee in Bankruptcy held that the trustee could invalidate the mortgage but only to the same extent that it was subject to challenge under California law by actual creditors on the date of bankruptcy. Accordingly, he rendered judgment in favor of the trustee for $8,906.95. On the trustee's petition for review, District Judge Ben Harrison reversed, holding that Section 70e of the Bankruptcy Act and this Court's decision in *Moore v. Bay*, 284 U. S. 4 (1931), demanded a complete invalidation of the mortgage and a resultant judgment for the trustee in the sum of $82,500.00.

The Court of Appeals affirmed. The effect is to require petitioners to pay back the value of the assets subject to the defective mortgage, at which time they will be entitled to receive dividends as general creditors on a claim for the entire amount then owing to them. (Bankruptcy Act, Secs. 57g, 57n, 11 U. S. C., Secs. 93g, 93n.)

There is nothing in the Record, however, to support such a claim, although the opinion of the Court of Appeals does unfortunately contain a similar error of fact.

In any event, the question of insolvency is immaterial under Sections 70e and 70c of the Bankruptcy Act, the provisions upon which the Court below relied in invalidating petitioners' chattel mortgage. Section 60 of the Act, pertaining to preferences, was not made a ground of the decision. For this reason, insolvency which is an element of a cause of action under Section 60, is now unimportant in the present case.

ARGUMENT:

I.

The Only Federal Questions Involved Are Well Settled. The Decision Below Clearly Is Correct, the Court Having Properly Applied Long Established Controlling Principles.

A. Petitioners' Mortgage Was Completely Invalid as Against the Trustee in Bankruptcy Under Section 70e of the Bankruptcy Act.

As seen above, on the date of bankruptcy petitioners' chattel mortgage was invalid under California law as against certain of the bankrupt's creditors who had claims totaling $8,906.95. Such being the case, Section 70e of the Bankruptcy Act enables the trustee to set aside the security in its entirety.

This section provides, in effect that a transfer or mortgage made by a bankrupt which for any reason is voidable under state law on the date of bankruptcy by any creditor having a provable claim is "null and void" as to the trustee. It is immaterial whether the transfer occurred within four months of bankruptcy or more than four months before, so long as creditors could attack it when the petition was filed.

Section 70e was construed in 1931 in *Moore v. Bay*, 284 U. S. 4, a unanimous decision written for the Court by Mr. Justice Holmes. While the opinion is brief, the record and the reported decision of the lower court[4] leave no doubt what was decided. The case arose in California and involved a chattel mortgage which was partially in-

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[4]In the lower courts, *Moore v. Bay* was carried under the caption *In re Sassard & Kimball*, 45 F. 2d 449 (C. A. 9, 1930).

valid because of failure to comply with the notice filing requirement of former Section 3440 of the Civil Code. The penalty for omitting the notice, like that for tardy recording, was to render the security defective only as against creditors coming into existence before recordation. The argument made in *Moore v. Bay* by the mortgagor's trustee was clearly set forth in the lower court's opinion in that case:

> "It is the contention of appellant [Trustee] that, under section 70e of the Bankruptcy Act . . . the mortgage in question, being void as to one creditor or class of creditors, is void in toto at the suit of the trustee."[5]

The Court of Appeals rejected this contention, holding that the trustee obtained no greater rights than the creditors who could attack the mortgage under state law:

> "There is no express language in this section [70e] which specifically gives to any unsecured creditor of a bankrupt any greater rights or any secured creditor any less right than he had before adjudication in bankruptcy. The rights of a trustee in bankruptcy to 'avoid any transfer' are no greater than those of a creditor or particular class of creditors. It is clear, we think, that a trustee in bankruptcy is limited in his control and disposition of the estate of the bankrupt to the rights of creditors as such rights existed and could be enforced under the state law prior to the time proceedings in bankruptcy were instituted."[6]

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[5] 45 F. 2d at 450.

[6] 45 F. 2d at 450.

After granting the trustee's petition for certiorari, the Supreme Court reversed this decision. Therefore, despite the brevity of the opinion, *Moore v. Bay* necessarily held that the trustee's power under 70e is to invalidate completely a defective transfer, even though it could be attacked only to a lesser extent by the creditor or creditors from whom the power is derived. That is to say, for Section 70e purposes there must exist at least one actual creditor as to whom the transfer is invalid; but once this is established, the *quantum* of the trustee's recovery is not measured by the creditor's rights.[7]

In the more than a quarter of a century which has elapsed since *Moore v. Bay* was decided, no Court of Appeals, Federal District Court or state court has failed to follow the rule that a transfer, voidable in part by creditors of the bankrupt under state law, is completely void under Section 70e of the Bankruptcy Act as against the trustee.[8] A number of cases illustrating the uniformity

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[7]The opinion also announces a second principle, namely, that the recovery thus made by the trustee is to be distributed pro rata to all the bankrupt's creditors in accordance with the distributive scheme of the Bankruptcy Act, and not merely to those claimants who could have challenged the transfer under state law. This second principle, however, is not questioned in the present case.

[8]Congress apparently placed its stamp of approval on *Moore v. Bay* when the following language was added to Section 70e(2) of the Bankruptcy Act in 1938: "All property of the debtor affected by any such transfer shall be . . . discharged and released from such transfer . . . and every such transfer . . . shall be avoided by . . . the trustee. . . ." See also, 4 Collier on Bankruptcy, par. 70.95, p. 1536.

with which the principle has been applied are collected in the footnote below.*

4 Collier on Bankruptcy, Par. 70.95, pp. 1533-1534, comments as follows on *Moore v. Bay*:

> "Since the decision in the *Bay* case, no dissenting voice has been raised by the courts. The accepted rule is that in a suit under §70e if the transfer or obligation is voidable at all, it is voidable *in toto*. Thus where a chattel mortgage, because it was not filed promptly after its execution, is void as against creditors who extended credit to the bankrupt during the interim, it is void as against the trustee in its entirety, regardless of the extent of such interim credit. . . . There can be no doubt that the Supreme Court ruled authoritatively on the matter, for the issue was squarely before the court."

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*Second Circuit: *City of New York v. Rassner*, 127 F. 2d 703, 707 (1942); *American Trust Co. v. New York Credit Men's Adjust. B.*, 207 F. 2d 685, 689 (1953); *Zamore v. Goldblatt*, 194 F. 2d 933 (1952), *cert. den.* 343 U.S. 979.

Fourth Circuit: *Friedman v. Sterling Refrigerator Co.*, 104 F. 2d 837, 840 (1939).

Fifth Circuit: *Corley v. Cozart*, 115 F. 2d 119, 121 (1940).

Sixth Circuit: *General Motors Acceptance Corporation v. Coller*, 106 F. 2d 584 (1939), *cert. den.* 309 U.S. 682; *Trailmobile, Inc. v. Wiseman*, 244 F. 2d 76 (1957); *Oliver Machinery Co. v. Bissell*, 261 F. 2d 596 (1958).

Eighth Circuit: *Mercantile Trust Co. v. Kahn*, 203 F. 2d 449 (1953).

District Courts: *In re Tobias*, 150 F. Supp. 288 (W. D. Mich., 1957); *In re Higgs*, 126 F. Supp. 16 (E.D. Mich., 1954); *Deane v. Fidelity Corporation of Michigan*, 82 F. Supp. 710 (W.D. Mich., 1949); *In re Independent Distillers of Kentucky*, 34 F. Supp. 708 (W.D. Ky., 1940); *In re Johnson*, 23 F. Supp. 337 (W.D. Mich., 1938).

State Courts: *E.g., Tatelbaum v. Nat'l Store Etc. Co.*, 196 Md. 599, 78 A.2d 228 (Ct. of App. Md., 1951).

See also,

1 Glenn, Fraudulent Conveyances and Preferences (Rev. ed. 1940), pp. 567-568.

There is no merit in the attempt to distinguish *Moore v. Bay* on the alleged ground that there the mortgage was "conclusively fraudulent and a nullity against all creditors" (Pet., p. 15), whereas here petitioners' security was invalid under state law only as to creditors whose claims arose before recordation. Not only does this attempt run counter to all the precedents, but also it misstates the California law. For failure to comply with the notice requirements of Section 3440 of the California Civil Code entails exactly the same penalty as failure to promptly record the chattel mortgage under Section 2957: The security becomes subject to attack only by creditors whose claims arise prior to recordation; as to all others, it is invulnerable.[10]

Petitioners are incorrect in asserting that *Buffum v. Peter Barceloux Co.*, 289 U. S. 227 (1933), is inconsistent with *Moore v. Bay*. On the contrary, *Buffum* held that a trustee suing under Section 70e could invalidate a fraudulent pledge transaction which had occurred about eight months before bankruptcy. Sections 70c and 70c of the Act do not contain a four month period of limitations as does Section 60 pertaining to preferences. The

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[10] "It is clear that the mortgage, by reason of the provisions of the statute [Civil Code, Sec. 3440], is void as to creditors of the first class [those whose claims existed on the date the mortgage was executed], and it is conceded it is also void as to those of the second class [those having claims which arose between execution of the mortgage and the time it was recorded]. As held by decisions of the Supreme Court of California, the mortgage would be valid as against creditors of the third class [those whose claims arose after recordation]." (Citing cases.) *In re Sassard & Kimball*, 45 F. 2d 449, 450, *rev'd sub nom. Moore v. Bay*, 284 U.S. 4.

statement by the Court in *Buffum* that the pledge was more than four months old, and hence unassailable if it were only a preference, is consistent with *Moore v. Bay* and the decision below in this case, since it refers to a different section of the Act.

Nor was there anything said or held in *Pepper v. Litton*, 308 U. S. 295 (1939), which is inconsistent with *Moore v. Bay*. *Pepper* concerned the distribution of the assets of an estate and the power of a Bankruptcy Court to subordinate the rights of creditors who had been guilty of fraud or inequitable conduct to claims of other creditors. It had nothing to do with the creation of an estate or the trustee's power to recover transfers or set aside liens, as did *Moore v. Bay*. *Pepper v. Litton* cannot be extended to the present case so as to bring petitioners ahead of the bankrupt's trade creditors who have committed no wrong. Moreover, petitioners' contention in this respect, and the similar equitable lien, estoppel and unjust enrichment theories, were raised for the first time at the oral argument in the Court below, a fact which by itself would require their rejection.

The so-called harshness in this case stems solely from the fact that petitioners neglected to comply with California's legislative policy which demands prompt recordation of mortgages to protect creditors from being victimized by secret encumbrances. Bankruptcy may have magnified to some extent the result of petitioners' carelessness, but they are assumed to have contracted with knowledge of the Federal as well as the State law, and they could have avoided the risk entirely by full compliance with the

filing statute. In this connection, the Fourth Circuit's observation in *Friedman v. Sterling Refrigerator Co.*, 104 F. 2d 837, 841 (1939), a case involving the *Moore v. Bay* principle, is equally applicable here:

> "Reference is made to cases of hardship which might occur as a result of the enforcement of the statute. The answer, of course, is that the vendor should protect himself by prompt recording. If he delays, he takes chances; and he is not relieved because the loss resulting therefrom may be greater than he may have anticipated or because it may have arisen through the creation of obligations by the debtor rather than through his dealing with the property which is the subject of the contract."

B. Section 70c of the Bankruptcy Act Compels the Complete Invalidation of Petitioners' Mortgage.

Although Section 70e alone would suffice, the Court below also applied 70c as an alternative ground to invalidate the security. This latter section, as amended in 1950, permits the trustee to set aside mortgages or other transfers so long as they are invalid as against any hypothetical creditor at the time of bankruptcy. As of that date in the present case, petitioners' mortgage was vulnerable to attack under California law by those who had granted credit to the bankrupt before recordation occurred. Accordingly, the trustee would prevail under Section 70c even if he could not prove, as he must for 70e purposes, that actual creditors had extended credit during the period the mortgage remained off record. Moreover, since the trustee's rights under Section 70c

do not derive from those of actual creditors, there can be no question but that his recovery under this provision involves complete invalidation of the security. Cases so holding are *Constance v. Harvey*, 215 F. 2d 571 (C. A. 2, 1954), *cert. den.* 348 U. S. 913; *Conti v. Volper*, 229 F. 2d 317 (C. A. 2, 1956); and *In re Kranz Candy Co.*, 214 F. 2d 588 (C. A. 7, 1954).

II.

There is No Conflict of Decision.

As seen in Part I of this brief, the principles relied upon by the Court below have been uniformly applied. Petitioners err when they assert that a conflict exists between the decision in the present case and the Third Circuit's holding in *In re Consorto Const. Co.*, 212 F. 2d 676 (1954). The Pennsylvania recording statute involved in the *Consorto* case protects only creditors who actually levy on the chattel mortgaged property prior to recordation, in contrast to the California statute which protects those extending credit prior to recordation, whether or not they obtain their liens prior thereto. Therefore, recordation having taken place in the *Consorto* case before bankruptcy, no hypothetical or actual creditor on that date could prevail in Pennsylvania over the chattel mortgagee, and the trustee accordingly could not rely on either Section 70c or 70e. But the Third Circuit expressly distinguished the California recording statute as construed in *Ruggles v. Cannedy*, 127 Cal. 290 (1899), indicating that a different conclusion would be required if the Pennsylvania law were similar.

Conclusion.

For each and all of the foregoing reasons, it is submitted that the petition for certiorari should be denied.

Respectfully submitted,

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